# Concentrated Family Ownership Structures Weakening

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# Concentrated Family Ownership Structures Weakening Corporate Governance: A Developing Country Story The Case of Indonesian Companies

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Abstract

research examines of ownership structures on corporate governance De. tat/ed anab'SIs utrma,ge carerul,h/ rracjng cnaun ownership , findings show that 62, of Intonesìan tm'S are contro//eð b'/ the owners who nave a majority ownership and that 63.81% 01' titms ate owned b/ an O,' group ot tarnil'/ members. mese ownership structures ate rnore inhibited than most other countries (Chessens et al 2000). Yet, the percentage of independent board (commissioners) is 39. Ot independent boatd memt•ers a rare event Indonesia f,fnp.e regression anary•sis reveals the: both ownership moderately significantpredictors Ownership structures in f/'dones'a influence lever bcarã independencEt rus Indonesian pattern is a somewhat extreme Bui "0! uncommon scenano jl}Aspan financz/marget$. Western may ar tive. Newewes ana regulations may 5B neecteg to pande mate protection a,'the stna,qet jnvestors.

key words: Ownership structures, govemance.developing

## Section 1 Introduction

Ït1i g pàper examines relatonship between ownûship and governance syuctures in Indonesia. This is a classic Asian counry with high ownewr,ip concentration and often large family ownerships. there tore, the typical western-styie corporate governance mechanLsms (e.g. Sarbanes-Oxley approacn) may be or counter a developing county scenario.

The paper is as toaws. Section 2 highlights the key literature and the agency theory links to hypothases tevetapment Then he research approach is ewainec in Sectjon 3, This is tollöwed by the descriptwand statsthal analysis in ection 4. The final sector. otters final conclusions.\

## Sectit n 2 Literature Review ownersmp structure and the agency problem

One important issue in the organizaton ot firms is how to solve or agency problem that derwes trom asymmetnc intormatan. Tne nature of a s structure will affect the nature ot the agency ant shareholders, anc among snareh01Cers.

But he problems that occur when firm ownership is dispersed are different to those that arise When it is cententrated_ When ownersrrlp is diffused, as is typical tar US and Uk corporations, conflicts of interest between managers and shareholders are a cent-al problem (Jensen and '/eckling 1976). However, When ownt rshiî concenrated to 'fie degree tnatone owner has ettectve control at Ine firm, as typically the case for firms in Asia, conflicts of interest between controlling shareholders and minority shareholders becomes the main pt0Blern,

Claessens, Ojankov and Lang (2000) investgated the separation of ownership [n selected Asian countnes. Theirtindlngs in tizate mata controlling single shareholder is prevalent in more than two-thirds of the turns while ne separaton of management trom ownership control was rare. Thus Aslan countries' owners nave sjanitjcant cower to pursue own interests at expense of minority sharehold creditors and other stakeholders. AS Shltiler and Vishny (1991) poont out, controlling snarenolcers may nat nave a convergence of nterestswitn rnvnonty snareholders, A greater d agree ot control by controlling sharehold implies a greater abiliti to exoropnate wean trom minority' Sharet101ders.

Past document the relaton between concentrated ownership structure and firm value. For example, Jensen and Heckling (1976) and Demsetz (1983) argue that managertal equity ownership will pravlde managers witn incenwes V) maximize value, Stukl (193B). hanever. has pro•vided a model Of ntrenched managers. where increased managenal owners-hi) allows managers to pursue non-value maxjmž„'ing agenaas. using U.S. data. Morck. Shleifer and Vishny have empirically Showed a nonlinear relation between tim value and manaaetiål ownershi9. They that firm value increases up to a° c:enajn 'eve' ot managenat (i, e. and Olen decreases as management holdings rise turutet. Similar results were also reported by McConnell and Servaes (1990; 1995). Hermaln and Weisbach

(2003) and Kole (1995).

Fan and Wong, (2002) conduct a study on the relatan between concentrated structure and financial reporting tar tie seven Asian countnes. They report that earnings intormatveness decreases as hth:llno snarenðiders Increase. They argue tlat is an expropriation of minority shareholders CainLng effective control ct a corporation enables the controlling owner10 detemne not just how TIE company run. nut also how are snared among shareholders. Although minority snuenåders are entitled to cash flow rights proportional to their Shara of equity ownersh•p. they tact the that an entitr,thtd conT011irg owner may opgartumsocally ceprive them of their nçnts. treates an žnztnchmentettect' (MorcketaL 1988). Thi enrenchment ptCblern created by a cornlina awrtet is similar to tne managerial envenchment problem. Higher managerial ownership rrognt entrench managers. as they are Increasingly less subject to governance mechanisms (Chang„

Hillman. andWåWl2005),

Separation of ownership rights and control rights can worsen the entrenchment problems caused by concentrated ownership. Controlling owners could extract wealth from the firm but only bear a part of the cost through a lower valuation of their cash-flow ownership. There is considerable literature documenting the existence of private benefits from control (Barclay and Holderness 1989; Zingales 1994, 1995; Nenova 2003; Dyck and Zingales 2004).[1] In particular, Nenova (2003) and Dyck and Zingales (2004) show

[1] Private benefits, sometimes called control benefits, are benefits that accrue to managers or shareholders that have control of the corporation, but not to minority shareholders. They can be non-pecuniary, such as influence over who is elected on the board of directors or in CEO position, the power to build business empires
(Nenova 2003), the ability to direct a company's resources to a cause one agrees
(Demsetz and Lehn 1985), a preference for glamorous project (Jensen 1993).



b" concenqated ownersïp. owners could ext-actwealth thetirm but only bear partof
cash-ftow ownernp, js considerable literature docu-

that higher private benefits frcrn Control are associated with: less developed capita: marr;ets: less prottCttd minority shareholders: and rnttre concentrated ownersnip.

In addition to the 'entrenchment effect, concentrated shareholCing; mighttreata an 'alignment effect'. Once controlling owner obtains firm, any increase in votnq riahts does notturther entrench the controlling '988). Fan and ffong(2002) ave that higher cash flow ownership will the controlling sharehdder more to divert the firm's cash flows for private gain High cash-flow owrership can serve as a signal that controllinq owner Will not expropriate weath trom minority Shareholders (Gomes 2000) because if minortty snaret101ders know that the controlling owner unexpectedly extracts more private öenetlts. will liscount the stock accardingav atld the majority owner's share vatue will be reduced (Fan Wong 2002}, Fan and '2002) argue further. in equilibrium, where a majority holds a large ownership stake will result (other things being equal) a price tor the company_ Thuse increasina a controlling owner's cash.tlow rights improves the alignment ot interests between the controlling owner and the minority snareholdets and reduces the effects ot ent:enctlment

C oncentraton ot owner shin and extensive tamilyco[lÿol characterise corporate in Asian countries and it is particularly most severe in Indonesia era,' 2000), Clatssens e,' al (2000) documented that around o: Indonesnn listed companies are while onlV are widely held. They find that nas ownership of any EastAs1an Country and has tile largest number or companies ov•vned ay a snalt

## Ownership Structure and corporate governance

Ownership structure pays an important role in governance. is a k4y organizatort variable influencing firm outcomes and Sorensen ownership structure IS a central dlStjnguishinç feature of financial systems and 2000) ard a element in determining corporate governance and (Stileiter ane ViShruy 1997: Qu and. therefore. witl other productive and technalogical resources can ha'e a significant influence cn company performance (Chrisman, Cltua, and Sharma 1998). Further. Porter (1990) importance at ownership structure and corporate govemancein determining corporate strategy:

> C goals art most determinec ty ownership the at ane holders ot debt. the nature corporate governance, ane processes that Shace motjvatjon of sensor managers. The ot publicly rettectthe charactîfistics of that nation's cap[tX markets (p,

Thus. ownership structure is an component in determining the natuœ of the agency problem; that [s. the Cominant tonfiict is managers and shareholders, or between controlling ana 'Tlinont„' key dimensions Of ownershiJ stucû.•re are. ownersnip concent:aðotl (ownership type) and the identity owners (ownershrp 2005), There have been a number ot studies on ant , its assacfâncn "ft.•mance (lemsetl and Lehr 1ÊB5, La and 1998: Himmertőtg. Hubbard. and Palia t Demsetz 2001 La for explanatory varinles to explain the ownership concentrattn in gubiicly rated firms wide set developed and unties, Antithet important aspect of co'porate ownership structure is Ile



they

identity of owners the compositcn of tne ownershiD A Shareno;aer can an individuat: a tank a zom;iny•. investor. ar a non.financial corporation. Not all omers are alike mple, Different types Tight haue Efferentjntžrest:, thereoy hawngüistnctinceatves and to ccntJ0' the managers a As L€hmann and Waipand V'ŽOOO) pointout: cen-

commitment owners and their Willingness intervene may crucially [jgoend on who ate 'n acatjon atconnngtvts can de a more important determinantot the degree ot convol exerted by owners than ownership concentration (p '62)L owners can be distncny tittærent rom one anner based on the specific expectations that they bring tone tirm the extent of meir actvg monitoflng ot the firm (Monks and Minow 1 Far exa significant holdings by insttüttonai investors age mare likely to lead to improued monitoring and control tnan atomistic owwship iHoskisson, Johnson. and 1994) because such parties nave an intive that is suffitiEfit tor them to necessary to monitor periormance (Alchian and Dernsetz lg72, and Vishny Holderness and Sheehan 1988: Gomes-Mejia 1989;

Sundaramutttv and Lyon 19981 In financial gwestors may be interested in short.terrn returns on their investment. wnle corporate investors may be more inclined towards establishing a long-term relatonsmp (Douma. George, and Kaöl[ 2006).

There have also been a nurnbM ot studies on ownership identjr,/ fflated to privattsatlon (Boycko , Stileitet. and ViShr.y• 1996: Ftieeman. Gray. Hessei. and Rapaczynski t ggg, Oyck 2001 cull. Matesova, antJ Shirley 200?h For example, 3yck (200 t) and Boyckö eta/. tourtd that tue'gn investors are the source ot better governance ant performance. However, Cull etal (2002) and Friedman et al (1999) found a contrary' result, tratis, domesue outsiders do better than foreign investors in privabsatons itt Republic

Ownership patterns vary significanåy across tconomið§ in successtui devetapéd economies, sup;yorted a well legal regulatory tramewor•g and with active oversight by reputable agents, agequatt Institutional and professional infrastructure. such as me I'S and dispersed ings have;yrowd2d an etticier•nase tor growth anc capital accumul Much ot the literature on corgorate governance •s based on diffused shareholding assumption Theretore, the literature mairåy ocuses on solving conflict between managers (as agents) and shattt10LdetS (as principles) that results tram the separation ot ownership and cont:ol.

HJwaver, a recent steam Into queston the assumpðon ot dittuse ownership and suggests coun- tn rnany economies concenrated pattern at ownership is more typical. example, Holderness, Kremer and snežnan (1999) an wease in managerial ownersilip in the USA (torn 13% in tS35 tn in 1"5. La portaet found thataverage ty me Tree largestshareholders ot non-financial firms trom is There have also been a number of studies trtat reave aocumentžd ex:stence of ownership by families. Fot La Portaž" examined the large 27 wealthy economies and taurld that thase firms are within families. Similarly, Chessens et al. (2000} examin¾ nine EastAsiar nes and found e tor,tentnton ot family ownership and (amity management. A relatvel'ý recentstudY by Anderson and Reeb shows that family cantolled fitrns epresent one-third of the S&P500 firms and. on average. 18 cutsänding equity.

As stated above, concentrated pattern of ownershia notžntially insiders to have Ijght control ot the rut it aiso up apwtunites to expropriate wealth trom Starenolders, Prowsž ( posits tat much uncrate governance LIS has been about the costs



eased concentration of ownership_
:oncentration is combined with

of dispersed equity' owrvship. ar•d to encourage increased prowse (1998, p.24} paints outtnat - ttis onpy wnen Thners.hß weak outside Sh areh01det protection laws in uncompetjBve Panartiål svstžm and opportunitjes ftr malfeasance and corruption by big powerful (insider) shareholders• that the costs associated With concentrated ownership be came highL

Compared to most developeC economes,, the tvusiness environment is quite different in many ot the emerging markel economies Fcvr example. most compances in Asian countries are affiliated with a business aroup that tarnily cantT0ilEd, The van atten comprise numerous publc and prwate compani {Claessens O;ank0Y, Fan, and Lana 2002) The limit/ effectve the companies in the group usina stock pyramids and cross-shareholdings. which can be quite complicated in Structure. ClatSSens et al. (2000) point Out that votng riçhts possessed by the tarnlly are frequently greater than the family's cash tow rights from the firm* and the results their study in nine East Asian es suggests that • Indonesa has mort than two-thirds (57 t S) of its publicly listec companies in family hands. and only 0.6% are held- (p 03). in witlin East Asia. Ingonesia has the largest number ot companies by a lamib,' (Claessens. Ojankav, and Lang 1999).

the concentrated tamily issue has ago neen conllrrnee In severa3 singte-econnmy studies: example. it South Korea. YChv Lee and WOidtk± (2001) in Taiwan. and Wiwattanakantang 1200" in Thailand. Concentrated family ownership corporate structures complicate the problems assocvated with asymmetncal informadon. Impedect monitoring. and appornmistc behaviour and make corporate governance retarm more compiez d on the above literature review. key e*Vlanatory variables (owrer type and owner identity) are utiliseö to predict the leer or or directors called board Of commissioners in next sections and analyse tne Indonestan data set

## Section 3 Research Approach

### Sample

To ensure data homogenejt/, this study focuses solely on manufacngring companies identified by the In donesian Capitat Market Directory (CMD). Anor,et reason t' manutactunng tirrns that these kinas ot ttrrns are dominant in Asia and Inertesiâ, As Dttawan. Mangåleswaræn, Padhi. Sankhe. Schwan and Paresi C2000i p.42) noted: 'Asia has become woñSht:-Þ Ct the world' more than half at all manufacturing Earth is esbrnated to take there. • Within the Indonesian context. Craig and Diga (1 p 248) noted that 'Indonesia was represented by manufacturing-type entties'

The sample exami med in this stuny cornpnses manufacturing companies listed on the JSX as at the end af 20Cô. a on .iSX, However. we are unable to collect sufficient intorrnaton to tull proxy 1 ittSleftwitfi a final sampleol tirms,

[1] 'Voting rights' refers the degree of control over a company, while 'cash flow rights
' refers to shareholdings in the firm. If, for example, a family owns 60% of Firm A
's equities, and Firm A owns 30% of Firm B's equities, then the family controls 30% of the voting rights of firm B but has only 18% (=60% * 30%) of the cash flow rights. ness


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Data sources The data sources used to trace the uttmatg owner ill sn.'ay wtïnate from ICMD oublieaðons issutd by the instjtutE for Economic and FinanciaEResearch (2004. 2001). These data provide the firm's immea•ati owners. These oy,ners are then and :ross-checked trrougn Indonesian B usiData Centre (153C) tlforrnaïon Resource Development (INFORDEV) (2000; Information Re. source Development (INFOROEV) (19£8) and firm'S prospectuses to determne a company's atl"iauon and. its uitrnate owner Given a firm could many uttimate owners; this 5tudy focuses On the largest ultimate owner To measure the degree of contol. this stldy combines shareholdings registered in the name ot the majority snareh016tt ant sharenoldefS (i.e. tnrougtl snares b'/ •najviŒuals. or companies that, in turn, under control). This procedure is justifiable 2007, since in Indonesia the tne companies on the capital market are tamil'/ controlled, Following Cluessenset al

(2000), this study does not distinguish individual tarnty members and uses the family group as the unit ot anarysis By identstyino tre name Shares are rag'stered. tÎliS study delineates tamfiY affiliation. shares oy individual members are trtated as a family ownership.

The eata sources measunnp me vanantes (deoeru:ent. Encependvntand control vanaötesj collected from tne and JSX Statistics, April volume 16. NJ issued by the JSX Resea:tn trid Development

Estimation Ot depe tide fit and independent variables

year and uses ownership as the prime predictors. Corporate aovernan ce is measured using the percentage of tne btare of commissnnets ot firm i at tinaraal staErnent 31 Dec Huber 2006 hat independent Ownership refers to the of a firm 's holders and the size ot holdinas (Oenjs and annel 2003) Thus. there aratwo key dimensjons ownership svucture analystd: ownership concentration (ownership and the identty of owners (Boubakriet al 2005).

Mural' (1989) cateaontet ownetShiÞ type into and Widely netd firms and noted that • Effective contyol is assumed to exist when ownership by an individual a small groop is greatzr tnan tittyvercent• mily's (ngo)_ Holderness anc Sheehan (1£88) type as either majonti held or diffusO and argued that •A shM8holder uhost primary objective is expropriation migntr,0'C more than ne (P_32ih Murali and welCh 11989) ana HOICerT1"s and Sheehan (1 Tils stuøy Cicnotomously categortzes ownership concenüation as either: maprity• ownerstllp: or non-maprvry ownetßhiï Ownershi' is it one owner (person. tamiiy. fa company) , govemment (local or nataraa'), cra foreign mult owning > dt the shares in a company'. A dummy oyed to categorize tirrnsv set eaual ta one a litm nas a majority oxnership structure and otherwise are

Mast ownetShiP structure immediate ownershiø: that common shares direct'/ owned dy intividiÄs cr insùtuðar,s. Fan and Bang (2002) argued that immediate owner ship is not sufficient for charactenz:ng me control et Asian firms ownevsïiP ant because these firms generally associated with structures. Therefore, complicated indirect ownership this study tocuses on træ ultmate ownership The uttmate owner is denned as the share-htlder Who has the determining votng ngnts ot comoany and Who is not controlled ty an,'b0dY (Fan and 2002}.

The ultimate ownership structures were computed by following existing studies (Claessens etal 2000: Facclo. Lang, and Yur,g 200Ÿ Claessens e,' al. 2002; Fztcloand Lanc 2002) matcarefuliy traced the chain ot ownership and identified the uttjmate owner(s) that conüatged tne mostvotng ngnts (the conling shareholder(s)) summing their direct ano inõirect ownership (voðng rignts) in a company]. In many cases. tne immeatate sharenoiaers a firm are enttes. or onvesrnent compan les other legal entitlå& Netl 2005). This study identfles their n•ners. the owners ot their owners, etc' Fan and (2002}, to economize On thï data collection. the uttjrnate owner' s voting rights level is set at 50% and not raced any furtheronce that majority is rdached. Claessens et a/ (2000) who studied ownership stucture and control in nine East Asian counties inducting Indonesia, documented that in most cases ultimate owner was an individual or 'amity This ig an irnportant motivator tor this stuCy which places :onsiderableemphasis on tamLly ownership,

This study then turther classifres ownership unere Indl','idual. or group ot farms,' members, h01d5 more man snares rants) and largest controlling block In the comp 01 the cut-off has also been adbptedby researchers such La Porta (1999) Studied corporate Ownershi' in 27 counties and (Claessense\ a]. 2000) who investiaated company ownership in nine EastAsian countries including Indonesèa. La Porta et at, 999), for argued thatthe idea bennd using a cut.ott is •this is usually enough to nave effective control of a firm* (m 477). Moreover. accorCing to Lngonesan Capital ) 1 g95) a person that directgy or irecty holt's at percent voting rtgnts company is catlec a •sunstanta' shareholder' Semoa.,' La Partaeta[ (1999) and Ciaassens at (2002), this stud} does consider ownership ty in uses the family as the unit ot analysis. Family ownetship agc covers the interests 0t tamaly merŸùQtS beyond their surnames (Lev it includes blood and marriage les) and families are assumed to and vote collectively' A companv is then classified according to data extracted from 'CMC, IBDC. and 'NFClRt)EV publications and tirrn•s prospectuses. A dummy vanablÊ useö to identity firms and is set equal to one it a tirm is considered to be owned ant otherwise,

Control variables

To control tor compou riding Lnfiúences of cross-sectional factors this study includes auditor type. size and leverage as control variables in the regression analysis. The perceived quality of the auditor is also considered to be a possible determinant of the firm financial performance (e.g., Frankel, Johnson,

[3] Direct ownership occurs through shares registered in the name of the ultimate owner. Indirect ownership occurs through shares held by entities that are controlled by the ultimate owner.
[4] In many cases, the ownership of
these immediate companies can be collected from the prospectus of each company in the sample.
[5] There are several definitions of family firms, for example, see Villalonga and Amit
(2004). They include different combinations of family ownership, management, and control. This study is based on ownership.
[6] Indonesian Capital Market Law (Article 1, 1995) defines 'family affiliation' as a
'family relationship by marriage' and 'family relationship by descent' both to the second degree, horizontally as well as vertically.

aud
itor is

ind Nelson 2002: GUI. Cnen, and Tsui 2003). Prior research usuaHy distinguishes non-Big 4 and Big auait firms arguing the atter to be of a higher quality than the former (Henirw2001 Mayhew and Wilki 20031. Thå5 sllty includes Big 4 as a for perceived auditor quality. Indicatorvariabte With firm i scored (1 the firrn•s auditor in fiscal year t is a Big 4 accounting otherwise scored zero O. Size is a'so to be expected an impact on tirms• governance structure (Black, Jang, Schmid, and Zimmerman 2003 Beirser, Orobetz, Schmidt and Zimmerman 20041 arownane Caylor 2004>, this study Size as another control in ffie regression mcdel. Size is calculated as the natural logarithm ot the total assets firm i at financial statement date 31 December 2006. Leverage is d include as priOt studies Show nattinanting decisions might innuence the tjrm•s corporate govemance (Blackel a'. 2003: Brown ana Caylor 2004) We define Leverage as ratio of book value total ottirm to value total ook assets Of i at financial statement aatt 31 ffnber 2005.

Proxy tar the gependent, independent and control vanables are detjr.ed Ln Table I as follows.

Table I: dðtinition and description

| Variable Descriptbn | Variable Title |
|---|---|
| Dependenl Variable | |
| Percentage of the board of commissioners of tm at statement date December 2C06 tat is independent | |
| Independent Variðbles | |
| Indicator variable with firm i scored one (1) if one owner (person. family. •s a company), the government (local or national), or tcojgn at tinantläl statement date 31 December 2006 has a majority cwtetsntp 7an ot t:tle shares in a company); otherwise scored zero (0) | Owner Type |
| titm v' ) an of family at titanc-iål stžzmentcate 31 Ječžmter21'lã rrwre Tan •at (votng n»ts) and IS the largest cont-Nita blËk in ne scored | owner 'ae,ntity |
| Control | |
| Indicator variable with firm i scored one (1) if their auditor at financial statement date 31 December 2006 is a Big 4 accounting firm; otherwise scored zero (0). | Aúðftor rype |
| Natural ot tie reported at fm i at SEŒmer1t 31 200€. | Size |
| Ratio of book value total liabilities ct nrm E ö00k value total assets of firm i at finarrtiil statement date 31 December 2006. | LevÉrage |

Section 4 Descriptive and Statistical Analysis

Table 2. Pareys A and provides descriptve statstcs tor dependant, independent and contro vanatyes.

Table 2: Descriptive statistics (N = 105)

| *Panel A – Continuous variables* | *Mean* | *Median* | *Standard Deviation* | *Minimum* | *Maximum* |
|---|---|---|---|---|---|
| *%IndBoard* | 39.12 | 33.33 | 11.17 | 0.00 | 80.00 |
| *Size* | 2,781,654 | 593,000 | 7,923,522 | 28,000 | 57,929,290 |
| *%Leverage* | 66.80 | 57.63 | 60.07 | 5.29 | 46.04 |

| *Panel B – Dummy regression variables* | *Frequency* | *Percentage* |
|---|---|---|
| *Owner Type* | | |
| *Majority* | 66 | 62.86 |
| *Non-majority* | 39 | 37.14 |
| *Owner Identity* | | |
| *Family* | 67 | 63.81 |
| *Non-family* | 38 | 36.19 |
| *Auditor Type* | | |
| *Big 4* | 50 | 47.62 |
| *Non-Big 4* | 55 | 52.38 |

Legend: *%IndBoard*: Percentage of the board of commissioners of firm *i* at financial statement date 31 December 2006 that is independent. *Size*: Total assets of firm *i* at financial statement date 31 December 2006. *Leverage*: Ratio of total liabilities of firm *i* to total assets of firm *i* at financial statement date 31 December 2006. *Owner Type*: Indicator variable with firm *i* scored one (1) if one owner (person, family, family's company), the government (local or national), or a foreign multinational has a majority ownership (more than 50% of the shares in a company); otherwise scored zero (0). *Owner Identity*: Indicator variable with firm *i* scored one (1) if an individual or group of family members, holds more than 20% of a firm's shares (voting rights) and is the largest controlling block in the company; otherwise scored zero (0). *Auditor Type*: Indicator variable with firm *i* scored one (1) if a company's auditor is a Big-4 accounting firm; otherwise scored zero (0)

Panel A in Table 2 indicates that the percentage of independent board has an average of 39.12% with a median of 33.33%. This is consistent with many other developing countries that the percentage of independent board directors/commisioners and independent members of the audit committee are under 50%. The size of the companies that are included in the sample has a mean of IDR2,781,654. Average total liabilities to total assets ratio (*Leverage*) of the sample firms is 66.80%. In relation to the ownership structure observed across the sample firms, Panel B of the table indicated that 62.86% of firms are controlled by the owners who have a majority ownership (more than 50% of a company's outstanding share). Panel B also shows that 63.81% of firms are owned by an individual or group of family members. This is consistent with Claessens *et al.* (2000) finding that Indonesian ownership concentration is higher than most other counties, with the major shareholders controlling El. of all corporations. Finally, anfy 47.62% at orrns hired a Sig 4 auditfirrn as t'ueir audftcy. This treauency rower than the case ot Australian andSingaporean (57.54% and 86.38% respectvet•y; (Rusmifi, Van der Zahnr Tower, and Brown 2006) , The man results' testing hypotheses (H, and H,) are reported in Table 3.

Table 3: Results at multivariate regression

| | t. stat | Sig. |
|---|---|---|
| (Constant) | | |
| Type | | |
| Owner Identity | .1662 | |
| Audi!0t Type | | |
| | | 0.573 |
| Leverage | | |
| Motel Summary | | |
| F•statstt | | 0.173 |
| R-SCüite | | |
| R- Squared | | |
| Sample Size | | |

Legend; • Moderately statistical significant p ≤ t'

The Table 3 regression model estimates* shows that the caettiÇient an Owner Type is positive and Statsðcaffy moderately s$afticant atp<O.057 Therefore, Hr is supported. This findin g infers that ownership concentraton has a gositve impact on corporate governance. Jensen and Meckling (IA76) and Dernsetz (1983). for examples, arçut managerial equiti ownership will provide managers with incentivesto ma"rnlze 'Irm aue_ £wever. result comradiCtve to Strnanjuntak (1999) who find that manaÞTtent of Indonesian Isted comp-lies generally under the control ot a majority shareholder Who tended tn act in tne interests of coraffolllfiÿ Shareholders by expropriatingweatthfrom the mtnorit•y shareholders. 3 also shows that a negatve and moderately significant associaton (at a

[7] A correlation matrix (not shown for brevity) reveals that %IndBoardis positively (negatively) associated with the Owner Type (Owner Identity) both for Pearson and Spearman correlations. In addition, there is no significant correlation amongst the two independent variables.
[8] Further backward regression analysis (again not shown for brevity) finds confirmatory results illustrating that Owner Type and Owner Identity are significant predictors of firms ' corporate governance (p-values 0.076 and 0.068 respectively).



moderate level. $p < 0.$ t D) between Owner tdentity the œorporate governance proxy This resubt supports the acceptance of ¹/, suggesting that the presente ot high c:ncenrated shareholdings by family members mi have an impact on corporate governance Specificalb'. the con¥trated family ownershig mi gnt have negatue impact on the corporate governance This is consistentwith pttvious studies in different countries. FOI example. (2003) in South Korea, Yeh et al. (20011 in Taiwan. and nakantang(2001 ) in Thailand documžtlt wncanvatedtamity ownership corporate stuctures complicate the problems associated wit. asymmerwal informaton. impertect monitoring. and opportu, nistic behaviour and make corporate governance retotm more complev

Further analy•sis using Incepencen•, Samples r.rests reveals that signitécant associaton between Majority and S"nasoard is driverr ny presence of high ownership concentration in tne firms. As shown in Tat)te 4. tne average vercentage at jnaependent board at commissioners in majority ownership firms (40.50%) is Sigrfticanty (atp<0062) nan tnosøot non.maþnt,' ownership firms

Table 4: Dest statistics — Type

| | | %Indgczld | | | |
|---|---|---|---|---|---|
| | N | Mean | so | | |
| 1 (Majority) | | | 12.73 | | 0.06Ž• |
| O (Non-ma/ority | | | | | |
| | | | | | |

Legend: •

Apart trom the incepgnrffilt coefficients on Auditor Type. Size and Leverage are all positive related to NncfBoard. This tinting is conrary to previous litetatute which assumer: 4 as quality ñnr$ings reported in r•umerous supportthatthe Big auditors provide higher quality audit tnan those Nan-BL' 4 (e.g., ðecger. oeFond, Jiambalvc, and Subramanyam 1998: Francis, Maydew. ane Sparks 1999 GOte, pope, ane Singh 2003). The insignificant relationship betR€en Sue and governance measurement is with previous research (e.g. Black et 2003: Beiner et al. and 2004). finally, the tr. Leverage is not completely consistent with previous works. examples Brown and (2004) anc Slack AL (2003), wno report positjue associ aton between leverage and corporate governance measurements

Section5 Conclusions

Asian companies have fundamentally dittertnt ownership than Western counterparts indonesLan companies are even more with verylarge family ownershi2 disøerSian of snares (Claessens e: al, 2000). This research project examines the effect Of such ownership snotu res on£orparate governance.

[9] Additional analysis, however, shows that that there is no significant difference between family and non-family-owned firms in placing independence board of commissioners of the companies (p = .123) with the %IndBoard average 37.85 and 41.35 percentage respectively.



Two sophistcated measures tor ownership mcturesarecreated The first is ownership type, Great tare was taken to determine the uttmate owner ny carefülty tracng the Of ownership and identtiÐd the ultrnate owner(s) that control tne mast vatng ngnts summing their direct and indirect ownership (votng rights) in a company. A dummy variable is used to categorize firms, set equal to one it a r,as a majott7•/ ownersn•p sructure and zero omer*'lse. snow tnat 62.86% ot firms are controlled by the owners who have a majority ownership. The second measure is that ownffrship identity. A dummy rariable is used to idenbty tirms and is over set to one il a firm is considered to be tamity owned (convolied) and zero otherwise. Our data reveals that Of fitms are owned by an ihdiVituål Of group Of family members. Thi s •s ntgtyerffian most other (CFaessens et al 2000).

In Indonesia, percentage of independent board (commissiorws) is 39.12%. A majority ot incependent board members remains a rare eventh Indonesia. Murtipie regression analysis reveals that both ownership type and identhy are mderatesignificantpredlctots tor board independence, Ownership sructures in Indonesia do inttuence revel board i,naepenaence.

These findings are likely to be alarming for the Indonesian regulator (BAPEPAM), Very ownership concentraton levels turret dc-mnat2d by tamiLjes are merent to the Indonesian corporate landVet, these ownership patterns directy reduce the independence 0t board members, Controls the owners untaitty treating rrtlt:ortty snarenalders are weakened. This Indonesian pattern is a somewhat out not uncommon scenario in Asian financial matkets. western solutions may not be applicable (it erective New nates and reguatonsmay to provide more protection the smauer Investors.

# Concentrated Family Ownership Structures Weakening

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GENERAL COMMENTS

**Instructor**

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